

Internal Revenue Service
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Department of the Treasury

Washington, DC 20224

Date [REDACTED]

Surname [REDACTED]
[REDACTED]
[REDACTED]

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to:

CP:E:EO:T:1:LMB

Date: MAY 7 1997

Employer Identification Number: [REDACTED]
Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(4). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

FACTS

You were incorporated on [REDACTED] as a nonprofit corporation under the laws of [REDACTED]. According to your Articles of Incorporation, your purpose is to provide [REDACTED] and [REDACTED] health care services through licensed dentists; to operate as a [REDACTED] service organization under [REDACTED] law; and to operate exclusively for social welfare purposes.

You operate a prepaid [REDACTED] service plan under which individuals or organizations on behalf of their employees or members pay you fixed monthly premiums. As a result, enrollees become eligible to receive each year from your contracted dentists certain [REDACTED] care services at no charge (two oral exams and one set of four x-rays) and two cleanings at a discounted fee. In addition, enrollees may obtain other [REDACTED] services from your contracted dentists at predetermined fees that represent an average discount of 30 percent below usual and customary fees. However, it is the enrollees' responsibility to pay for these other [REDACTED] services.

According to your bylaws, you have no members. Your bylaws provide that you have a self-perpetuating board of directors which consists of no less than three persons. Currently, your board of directors consists of four persons, including [REDACTED], [REDACTED]; and [REDACTED] their daughter. [REDACTED] is President of [REDACTED], a nonexempt corporation that has contracted to provide you with various services described below.

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[REDACTED]

The shareholders of [REDACTED] are Mr. [REDACTED] and Mrs. [REDACTED] and its board of directors consists of Mr. [REDACTED] Mrs. [REDACTED] and [REDACTED].

You intend that your board will be comprised of persons who are representative of your community, including dentists and representatives of groups such as senior citizens, [REDACTED] and community service groups. However, your bylaws do not require that your board broadly represent the community.

Currently, you have 568 enrollees, all of whom are individuals. The monthly premiums you charge are \$[REDACTED] for individuals, \$[REDACTED] for couples and \$[REDACTED] for families. Your premiums are based on the costs of doing business, administration, marketing, capital investments, payroll, etc. You stated that your premiums are below what is being charged by indemnity [REDACTED] plans. Only persons enrolled in your plan may obtain the dental services described above from your contracted dentists at the agreed discounted fees.

As of June 30, 1996, you had provider contracts with 25 dentists. Under these contracts, you pay the following monthly fees to each dentist based on enrollment: \$[REDACTED] for individuals, \$[REDACTED] for couples and \$[REDACTED] for families.

Your dental plan is administered by [REDACTED] under an Administration Agreement effective January 1, 1995. Under this agreement, [REDACTED] performs various management and administrative services. In consideration for the services provided, you pay [REDACTED] 20 percent of your plan's gross revenues. You have submitted no independent support establishing the reasonableness of this fee arrangement based on the services performed.

Once a person is enrolled, you may terminate the enrollee only for non-payment of premiums. You do not provide any subsidies for persons who need dental care but who cannot afford to pay your premiums. You do not conduct any [REDACTED] educational programs for the community or provide any free or reduced rate [REDACTED] care for persons in the community who need [REDACTED] care but who cannot afford to pay for it. Further, your contracted dentists are not required to engage in any community benefit activities or provide free or reduced rate [REDACTED] care services to needy persons in the community.

LAW

Section 501(c)(4) of the Code provides for the exemption from federal income taxation of civic leagues or organizations

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not organized for profit but operated exclusively for the promotion of social welfare, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations defines the words "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(4)-1(a)(1) of the regulations provides that an organization is described in section 501(c)(4) of the Code if (1) it is not organized or operated for profit and (2) it is operated exclusively for the promotion of social welfare. Section 1.501(c)(4)-1(a)(2)(i) of the regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

While a social welfare organization necessarily benefits private individuals in the process of benefiting the community as a whole, even when the benefits are confined to a particular group of individuals, the organization may be exempt if the general community derives a substantial benefit. Conversely, an organization that benefits a large number of people will not necessarily be organized for social welfare purposes within the meaning of section 501(c)(4) because numbers are not necessarily determinative of social welfare objectives. Social welfare is the well being of persons as a community and classification depends upon the character as public or private -- of the benefits bestowed, of the beneficiary, and of the benefactor. See Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962).

RATIONALE

1. Although a social welfare organization necessarily benefits private individuals in the process of benefiting the community as a whole, the organization may be exempt if the general community derives a substantial benefit. Conversely, an organization that benefits a large number of people will not necessarily be organized for social welfare purposes because numbers are not necessarily determinative of social welfare objectives. See Commissioner v. Lake Forest, Inc., *supra*.

Therefore, the issue is whether your organization's activities result in so much private benefit as to preclude it from qualifying as a social welfare organization. The test in

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resolving this question with respect to exemption under section 501(c)(4) of the Code is "primarily," which, as used in section 1.501(c)(4)-1(a)(2)(i) of the regulations, means that some amount of private benefit may be permissible so long as your organization's activities remain primarily social welfare. This necessarily requires weighing the extent to which your organization's activities are social welfare activities versus those that result in a private benefit.

By offering enrollment in your plan to individuals at rates that appear reasonably designed to encourage maximum participation in a preventive care [redacted] program, you provide a benefit to the community.

2. Under your agreement with [redacted], [redacted] provides you with various administrative and management services. One of your board members, Mr. [redacted], is president of [redacted]. Mr. [redacted] and his wife are also the sole shareholders of [redacted]. In addition, Mr. [redacted], Mrs. [redacted] and [redacted] are the directors of [redacted]. Under your agreement with [redacted], you pay [redacted] fees equal to 20 percent of your plan's gross revenues. You have submitted no independent support establishing the reasonableness of this fee arrangement based on the services performed. Further, this arrangement was negotiated by your self-perpetuating board of directors, who are financially interested parties, which results in an open-ended fee structure that permits [redacted] to participate in a profit-sharing type arrangement with your organization. Nevertheless, even if the fee arrangement were reasonable, it is logical to conclude that the terms of this agreement were not negotiated on an arm's length basis but represent an exclusive arrangement that makes your plan merely an adjunct to [redacted] business. This arrangement demonstrates that you do not benefit the community as a whole and thus you are not primarily engaged in promoting in some way the common good and general welfare of the people of the community, as required by section 1.501(c)(4)-1(a)(2)(i) of the regulations.

Under all the facts and circumstances, including the formation of your organization, the control of your organization and your exclusive arrangements with the [redacted] business interests, the character of your activities more closely furthers private rather than public interests. See Commissioner v. Lake Forest, Inc., supra. Moreover, this arrangement violates the proscription against private inurement in section 501(c)(4).

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CONCLUSION

For the reasons stated above, you do not qualify for exemption as an organization described in section 501(c)(4) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED]
[REDACTED]
[REDACTED]

For your convenience, our FAX number is [REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

[REDACTED]
[REDACTED]
Chief, Exempt Organizations
[REDACTED]